SEC

OFFICE *of* INVESTOR EDUCATION *and* ADVOCACY

Financial Navigating in the Current Economy:

Things to Consider Before You Make Investing Decisions

Given recent market events, you may be wondering whether you should make changes to your investment portfolio. The SEC's Office of Investor Education and Advocacy is concerned that some investors are making rapid investment decisions without considering their long-term financial goals. While we can't tell you how to manage your investment portfolio during a volatile market, we are issuing this Investor Alert to give you the tools to make an informed decision. Before you make any decision, consider these areas of importance:

Evaluate your current financial roadmap.

Before you make any investing decision, sit down and take a fresh look at your entire financial situation. An important step to successful investing is knowing your current goals and risk tolerance. These factors may have changed with the current economy.

Evaluate your comfort zone in taking on risk.

Traditionally, if you have a financial goal with a long time horizon, you are likely to make more money by carefully investing in asset categories with greater risk, like stocks or bonds, rather than restricting your investments to assets with less risk, like cash equivalents. On the other hand, investing solely in cash investments may be appropriate for short-term financial goals. The principal concern for individuals investing in cash equivalents is inflation risk, which is the risk that inflation will outpace and erode returns over time. With today's market volatility, investors must evaluate their acceptance and comfort zone for risk. Can you stomach the current up-and-down market for longer term goals?

Consider an appropriate mix of investments.

Historically, the returns of the three major asset categories – stocks, bonds, and cash – have not moved up and down at the same time. Market conditions that cause one asset category to do well often cause another asset category to have average or poor returns. By investing in more than one asset category, you'll reduce the risk that you'll lose money and your portfolio's overall investment returns will have a smoother ride. If one asset category's investment return falls, you'll be in a position to counteract your losses in that asset category with better investment returns in another asset category.

One of the most important ways to lessen the risks of investing is to diversify your investments – both among asset categories and within asset categories. It's common sense: don't put all your eggs in one basket. By picking the right group of investments, you may be able to limit your losses and reduce the fluctuations of investment returns without sacrificing too much potential gain.

You'll be exposed to significant investment risk if you invest heavily in shares of your employer's stock. If that stock does poorly or the company goes bankrupt, you'll probably lose a lot of money (and perhaps your job).

Lifecycle Funds

To accommodate investors who prefer to use one investment to save for a particular investment goal, such as retirement, some mutual fund companies have begun offering a product known as a "lifecycle fund." A lifecycle fund is a diversified mutual fund that automatically shifts towards a more conservative mix of investments as it approaches a particular year in the future, known as its "target date." A lifecycle fund investor picks a fund with the right target date based on his or her particular investment goal. The managers of the fund then make all decisions about asset allocation, diversification, and rebalancing. It's easy to identify a lifecycle fund because its name will likely refer to its target date. For example, you might see lifecycle funds with names like "Portfolio 2015," "Retirement Fund 2030," or "Target 2045."

Create and maintain an emergency fund.

One of the most important ways to lessen the risks of investing is to diversify your interests-both among asset categories and within asset categories.

Most smart investors put enough money in a savings product to cover an emergency, like sudden unemployment. Some make sure they have up to six months of their income in savings so that they know it will absolutely be there for them when they need it. During a downturn of the economy, this is particularly important.

Federally Insured Deposits at Banks and Credit Unions

If you're not sure if your deposits are backed by the full faith and credit of the U.S. government, it's easy to find out. For bank accounts, go to www.myfdicinsurance.gov. For credit union accounts, go to http://webapps.ncua.gov/Ins/.

Consider dollar cost averaging.

Through the investment strategy known as "dollar cost averaging," you can protect yourself from the risk of investing all of your money at the wrong time by following a consistent pattern of adding new money to your investment over a long period of time. By making regular investments with the same amount of money each time, you will buy more of an investment when its price is low and less of the investment when its price is high. Individuals that typically make a lump-sum contribution to an individual retirement account either at the end of the calendar year or in early April may want to consider "dollar cost averaging" as an investment strategy, especially in today's volatile market.

Keep Your Money Working

In most cases, a workplace plan is the most effective way to save for retirement. Consider your options carefully before borrowing from your retirement plan. In particular, avoid using a 401(k) debit card, except as a last resort. Money you borrow now will reduce the savings available to grow over the years and ultimately what you have when you retire. Also, if you don't repay the loan, you may pay federal income taxes and penalties.

Consider rebalancing your portfolio occasionally.

Rebalancing is bringing your portfolio back to your original asset allocation mix. By rebalancing, you'll ensure that your portfolio does not overemphasize one or more asset categories, and you'll return your portfolio to a comfortable level of risk.

You can rebalance your portfolio based either on the calendar or on your investments. Many financial experts recommend that investors rebalance their portfolios on a regular time interval, such as every six or twelve months. The advantage of this method is that the calendar is a reminder of when you should consider rebalancing. Others recommend rebalancing only when the relative weight of an asset class increases or decreases more than a certain percentage that you've identified in advance. The advantage of this method is that your investments tell you when to rebalance. In either case, rebalancing tends to work best when done on a relatively infrequent basis.

Avoid circumstances that can lead to fraud.

Scam artists read the headlines, too. Often, they'll use a highly publicized news item to lure potential investors and make their "opportunity" sound more legitimate. This can be particularly true during troubled economic times when investors are frustrated. The SEC recommends that you ask questions and check out the answers with an unbiased source before you invest. Always take your time and talk to trusted friends and family members before investing.

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